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BEFORE THE ARIZONA CORPORATION COMMISSION

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**COMMISSIONERS**

GARY PIERCE- Chairman  
BOB STUMP  
SANDRA D. KENNEDY  
PAUL NEWMAN  
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF  
ARIZONA TELEPHONE COMPANY, AND  
ARIZONA CORPORATION, FOR A  
HEARING TO DETERMINE THE EARNINGS  
OF THE COMPANY, THE FAIR VALUE OF  
THE COMPANY FOR RATEMAKING  
PURPOSES, AND TO INCREASE  
RESIDENTIAL RATES AS NECESSARY TO  
COMPENSATE FOR THE RATE IMPACTS  
OF THE FCC'S USF/ICC  
TRANSFORMATION ORDER

DOCKET NO. T-02063A-12-0302

**STAFF'S NOTICE OF FILING**

At the hearing on this matter, Arizona Corporation Commission ("Commission") Staff agreed to provide information on the Federal Communications Commission's ("FCC") Report and Order and Further Notice of Proposed Rulemaking ("Order") which establishes the local service rate floors at issue in this case. The Order was released on November 18, 2011, in WC Docket No. 10-90 (Connect America Fund); GN Docket No. 09-51 (A National Broadband Plan for our Future); WC Docket No. 07-135 (Establishing Just and Reasonable Rates for Local Exchange Carriers); WC Docket No. 05-337 (High Cost Universal Service Support); CC Docket No. 01-92 (Developing an Unified Intercarrier Compensation Regime); CC Docket No. 96-45 (Federal-State Joint Board on Universal Service); WC Docket No. 03-109 (Lifeline and Link-Up) and WT Docket No. 10-208 (Universal Service Reform – Mobility Fund).

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Arizona Corporation Commission

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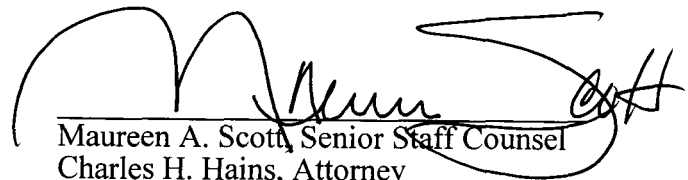
OCT 16 2012

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*LYM*

1 Staff has attached copies of pages 87 through 94 of the Order which discuss the FCC's local  
2 service rate floors which carriers must meet or lose federal high cost loop support and CAF Phase I  
3 support on a dollar for dollar basis to the extent that a carrier's local rates (including state regulated  
4 fees) do not meet the urban rate floor.

5 RESPECTFULLY SUBMITTED this 16<sup>th</sup> day of October, 2012.  
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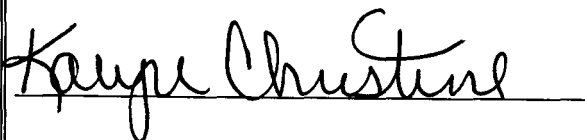
Maureen A. Scott, Senior Staff Counsel  
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10  
11  
12  
13  
14 Original and thirteen (13) copies  
15 of the foregoing filed this  
16<sup>th</sup> day of October 2012 with:

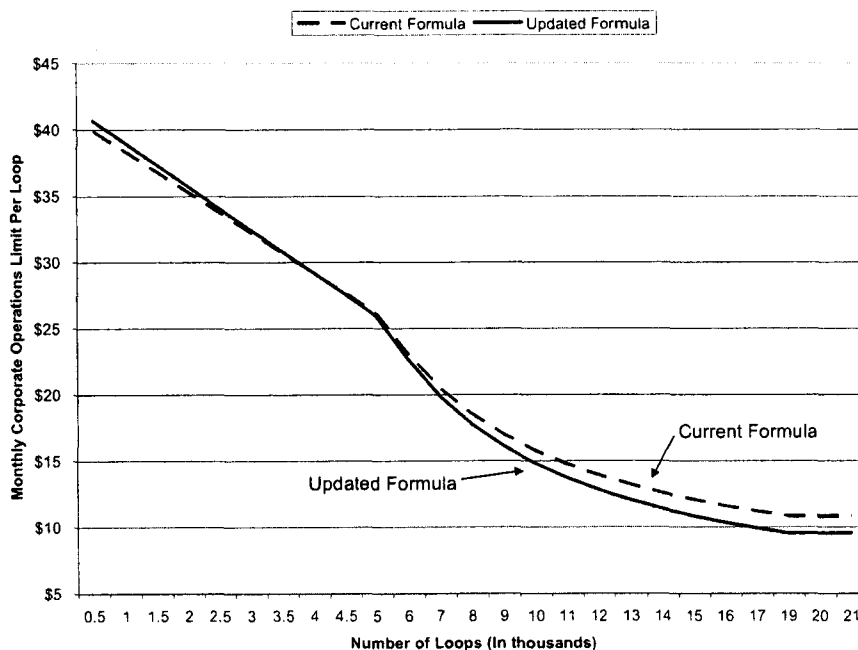
16 Docket Control  
17 Arizona Corporation Commission  
18 1200 West Washington Street  
19 Phoenix, Arizona 85007

20 Copy of the foregoing mailed this  
21 16<sup>th</sup> day of October 2012 to:

22 Craig A. Marks  
23 Craig A. Marks, PLC  
24 10645 North Tatum Boulevard  
25 Suite 200-676  
26 Phoenix, Arizona 85028  
27  
28



Corporate Operations Expense Limit Formula: Current vs. Updated



## 5. Reducing High Cost Loop Support for Artificially Low End-User Rates

234. *Background.* Section 254(b) of the Act requires that “[c]onsumers in all regions of the Nation . . . should have access to telecommunications and information services . . . that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.”<sup>374</sup> In the *USF/ICC Transformation NPRM*, we sought comment on tools, such as rate benchmarks and imputation of revenues, that might be used both today and as the marketplace fully transitions to broadband networks to meet this statutory mandate.<sup>375</sup> Among other things, we sought comment on using a rate benchmark, or floor, based on local rates for voice service at the outset of any transition for high-cost support reform.<sup>376</sup> One commenter, in response to the *USF/ICC Transformation NPRM*, suggested we develop a benchmark for voice service and reduce a carrier’s high-cost support by the amount that its rate falls below the benchmark.<sup>377</sup>

235. *Discussion.* We now adopt a rule to limit high-cost support where end-user rates do not meet a specified local rate floor. This rule will apply to both rate-of-return carriers and price cap companies.

<sup>374</sup> 47 U.S.C. § 254(b)(3).

<sup>375</sup> *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4733-34, para. 573. Under a benchmark approach, the benchmarked rate is imputed to the carrier for purposes of determining support, but carriers typically are not required to raise their rates to the benchmark level.

<sup>376</sup> *Id.* See also *id.* at 4603, para. 139 and n. 223 (seeking comment on developing a rate benchmark for voice [and broadband] services to satisfy Congress’s requirement that universal service ensure that services are available to all regions, “including rural, insular, and high cost areas,” at rates that are “affordable” and “reasonably comparable” to those in urban areas).

<sup>377</sup> Ad Hoc *USF/ICC Transformation NPRM* Comments at 26. We sought comment specifically on this approach in a subsequent Public Notice addressing specific aspects of additional proposals and issues. *August 3 PN*, 26 FCC Rcd at 11118.

Section 254 obligates states to share in the responsibility of ensuring universal service. We recognize some state commissions may not have examined local rates in many years, and carriers may lack incentives to pursue a rate increase when federal universal service support is available. Based on evidence in the record, however, there are a number of carriers with local rates that are significantly lower than rates that urban consumers pay.<sup>378</sup> Indeed, as noted in Figure 5 below, there are local rates paid by customers of universal service recipients as low as \$5 in some areas of the country. For example, we note that two carriers in Iowa and one carrier in Minnesota offer local residential rates below \$5 per month.<sup>379</sup> We do not believe that Congress intended to create a regime in which universal service subsidizes artificially low local rates in rural areas when it adopted the reasonably comparable principle in section 254(b); rather, it is clear from the overall context and structure of the statute that its purpose is to ensure that rates in rural areas not be significantly higher than in urban areas.

236. We focus here on the impact of such a rule on rate-of-return companies.<sup>380</sup> Data submitted by NECA summarizing residential R-1 rates for over 600 companies — a broad cross-section of carriers that typically receive universal service support — show that approximately 60 percent of those study areas have local residential rates that are below the 2008 national average local rate of \$15.62. This distribution plot shows that most rates fall within a five-dollar range of the national average, but more than one hundred companies, collectively representing hundreds of thousands of access lines, have a basic R-1 rate that is significantly lower. This appears consistent with rate data filed by other commenters.<sup>381</sup>

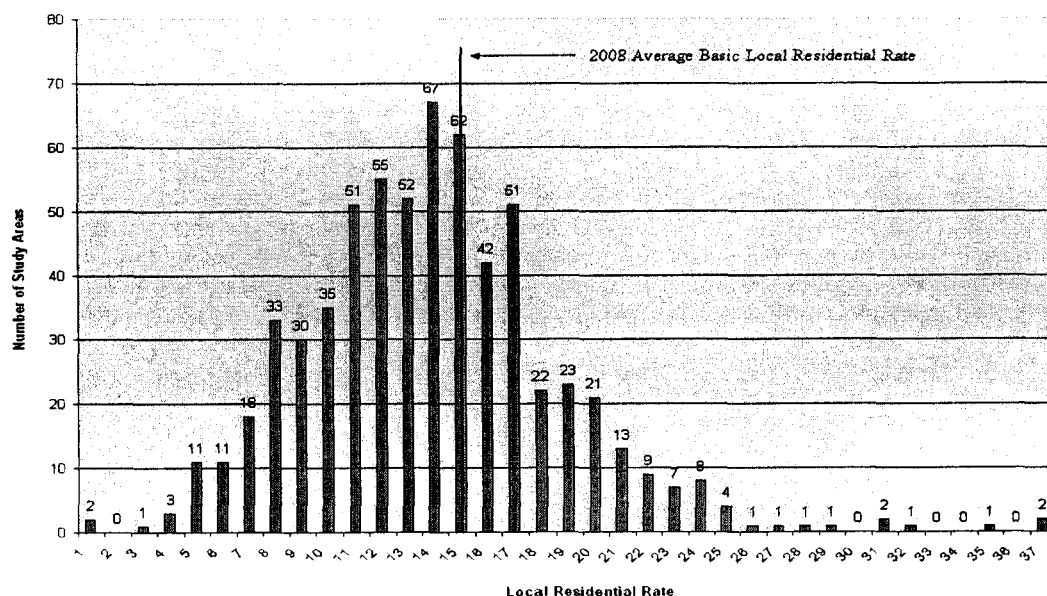
<sup>378</sup> In the *August 3 PN*, we stated that our high-cost universal service rules may subsidize excessively low rates for consumers served by rural and rate-of-return carriers. *August 3 PN*, 26 FCC Rcd at 4614-15, para. 172. We noted that one commenter stated that roughly 20 percent of the residential lines of small rate-of-return companies have monthly rates of \$12 or less and another 22 percent have local rates between \$12 and \$15 per month, while the nationwide average urban rate, it contends, was approximately \$15.47 based on the most recent published reference book of rates by the FCC. *Id.* While individual consumers in those areas may benefit from such low rates, when a carrier uses universal service support to subsidize local rates well below those required by the Act, the carrier is spending universal service funds that could potentially be better deployed to the benefit of consumers elsewhere. *Id.*

<sup>379</sup> Local residential rates, or flat rates for residential service, are more commonly referred to as the “R-1” rate. See, e.g., Letter from the Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed February 5, 2007) (referencing “the basic residential local rate (1FR or equivalent)”).

<sup>380</sup> While price cap companies on average tend to have higher R-1 rates than rate-of-return companies, we note that data in the record indicates that a number of price cap companies also have local R-1 rates below the most recently available national average local rate, \$15.62, in a number of states. See Letter from Malena F. Barzilai, Regulatory Counsel & Director, Windstream Communications, to Marlene H. Dortch, Secretary, FCC, Confidential Information Subject to Protective Order in CC Docket No. 01-92, WC Docket Nos. 05-337, 07-135, 10-90, and GN Docket No. 09-51 (filed Oct. 15, 2011) (*NECA Survey*); Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier Communications, to Marlene H. Dortch, Secretary, FCC, Confidential Information Subject to Protective Order in CC Docket No. 01-92, WC Docket Nos. 05-337, 07-135, 10-90, and GN Docket No. 09-51 (filed Dec. 16, 2010). In fact, price cap companies have some R-1 rates lower than \$9.

<sup>381</sup> The data for this distribution comes from the *NECA Survey*. See also Oregon Telecommunications Association and the Washington Independent Telecommunications Association Comments, Table 7 (filed July 12, 2010) (providing existing monthly local residential rates ranging from \$10.00 to \$27.39 not including subscriber line charges of \$6.50 per month); Oregon Telecommunications Association and the Washington Independent Telecommunications Association Reply Comments, Table 3 (filed August 11, 2010) (providing existing monthly local residential rates ranging from \$12.25 to \$30.50 not including subscriber line charges of \$6.50 per month).

Figure 5  
**Sample of Local Residential Service Monthly Rates**  
**NECA Survey of 641 Respondents**



237. It is inappropriate to provide federal high-cost support to subsidize local rates beyond what is necessary to ensure reasonable comparability. Doing so places an undue burden on the Fund and consumers that pay into it. Specifically, we do not believe it is equitable for consumers across the country to subsidize the cost of service for some consumers that pay local service rates that are significantly lower than the national urban average.

238. Based on the foregoing, and as described below, we will limit high-cost support where local end-user rates plus state regulated fees (specifically, state SLCs, state universal service fees, and mandatory extended area service charges) do not meet an urban rate floor representing the national average of local rates plus such state regulated fees. Our calculation of this urban rate floor does not include federal SLCs, as the purposes of this rule change are to ensure that states are contributing to support and advance universal service and that consumers are not contributing to the Fund to support customers whose rates are below a reasonable level.<sup>382</sup>

239. We will phase in this rate floor in three steps, beginning with an initial rate floor of \$10 for the period July 1, 2012 through June 30, 2013 and \$14 for the period July 1, 2013 through June 30, 2014. Beginning July 1, 2014, and in each subsequent calendar year, the rate floor will be established after the Wireline Competition Bureau completes an updated annual survey of voice rates. Under this approach,

<sup>382</sup> See 47 U.S.C. §§ 254(b)(5), 254(f), 254(k); *Federal-State Joint Board on Universal Service*, Order on Remand, CC Docket No. 96-45, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, 22568 para. 17 (2003) (“The Act makes clear that preserving and advancing universal service is a shared federal and state responsibility.”).

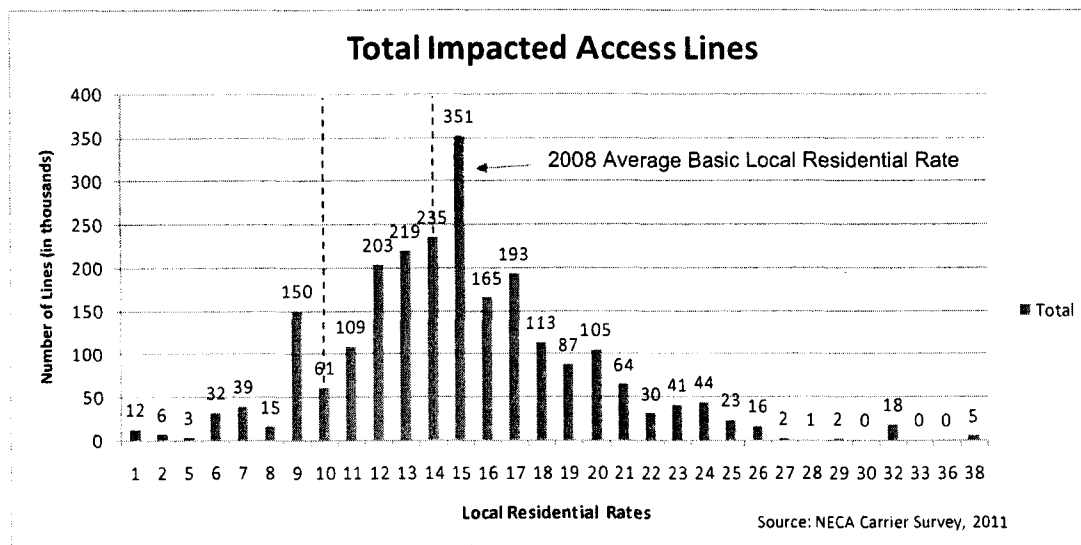
the Commission will reduce, on a dollar-for-dollar basis, HCLS and CAF Phase I support to the extent that a carrier's local rates (plus state regulated fees) do not meet the urban rate floor.

240. To the extent end-user rates do not meet the rate floor, USAC will make appropriate reductions in HCLS support. This calculation will be pursuant to a rule that is separate from our existing rules for calculation of HCLS, which is subject to an annual cap. As a consequence, any calculated reductions will not flow to other carriers that receive HCLS, but rather will be used to fund other aspects of the CAF pursuant to the reforms we adopt today.<sup>383</sup>

241. This offset does not apply to ICLS because that mechanism provides support for interstate rates, not intrastate end-user rates. Accordingly, we will revise our rules to limit a carrier's high-cost loop support when its rates do not meet the specified local urban rate floor.<sup>384</sup>

242. As shown in Figures 6 and 7 below, phasing in this requirement in three steps will appropriately limit the impact of the new requirement in a measured way. Based on the NECA data, we estimate that there are only 257,000 access lines in study areas having local rates less than \$10 – which would be affected by the rule change in the second half of 2012 – and there are 827,000 access lines in study areas that potentially would be affected in 2013.<sup>385</sup> We assume, however, that by 2013 carriers will have taken necessary steps to mitigate the impact of the rule change. By adopting a multi-year transition, we seek to avoid a flash cut that would dramatically affect either carriers or the consumers they serve.

Figure 6

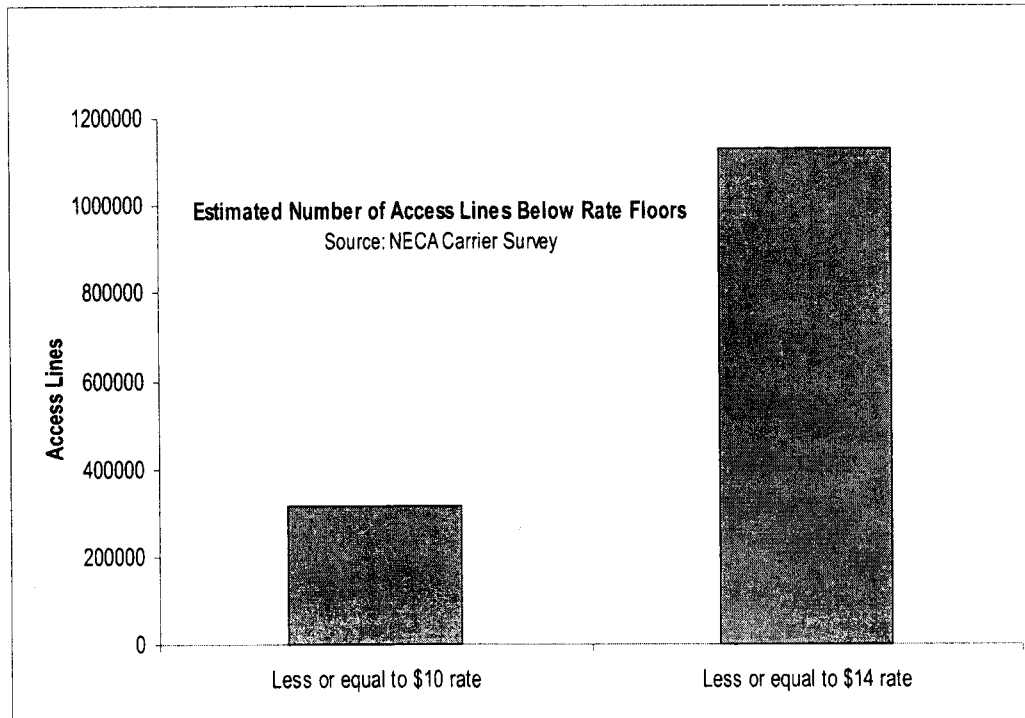


<sup>383</sup> See *supra* Section VII.H.

<sup>384</sup> See *infra* Section 54.318, Appendix A.

<sup>385</sup> The data for this distribution comes from the *NECA Survey*. See *supra* note 381.

Figure 7



243. In addition, because we anticipate that the rate floor for the third year will be set at a figure close to the sum of \$15.62 plus state regulated fees, we are confident that \$10 and \$14 are conservative levels for the rate floors for the first two years. \$15.62 was the average monthly charge for flat-rate service in 2008, the most recent year for which data was available.<sup>386</sup> Under our definition of “reasonably comparable,” rural rates are reasonably comparable to urban rates under section 254(b) if they fall within a reasonable range above the national average.<sup>387</sup> Under this definition, we could set the rate floor *above* the national average urban rate but within a range considered reasonable. In the present case, we are expecting to set the end point rate floor *at* the average rate, and we are setting rate floors well *below* our current best estimate of the average during the multi-year transition period.

<sup>386</sup> Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, Industry Analysis and Technology Division, Wireline Competition Bureau, Residential Rates for Local Service in Urban Areas, Table 1.1 (2008) (2008 Reference Book of Rates). We note that some parties have submitted information into the record indicating that the local rates are higher than this \$15.62 figure in a number of states. For example, Kansas has increased its affordable residential rates for rural incumbent LECs to \$16.25 per month, and Nebraska has conditioned state USF eligibility upon carriers increasing local rates to its adopted rate floor of \$17.95 in urban areas and \$19.95 in rural areas. Letter from Mark Sievers, Chairman, Kansas Corporation Commission; Orjiakor Isiogu, Chairman, Michigan Public Service Commission; Tim Schram, Chairman, Nebraska Public Service Commission; Patrick H. Lyons, Chairman, New Mexico Public Regulation Commission; Steve Oxley, Deputy Chair, Wyoming Public Service Commission, to Marlene H. Dortch, Secretary, FCC, re: Universal Service Intercarrier Compensation Transformation Proceeding, WC Docket Nos. 10-90, 07-135, 05-337 and 03-109; CC Docket Nos. 01-92 and 96-45; GN Docket No. 09-51 (filed September 15, 2011).

<sup>387</sup> Federal-State Joint Board on Universal Service, High-Cost Universal Service Support, WC Docket No. 05-337, CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072, 4101, para. 53 (2010) (Qwest II Remand Order).

244. Although the high-cost program is not the primary universal service program for addressing affordability, we note that some commenters have argued that if rates increase, service could become unaffordable for low-income consumers.<sup>388</sup> However, staff analysis suggests that this rule change should not disproportionately affect low-income consumers, because there is no correlation between local rates and average incomes in rate-of-return study areas—that is, rates are not systematically lower where consumer income is lower and higher where consumer income is higher. We further note that the Commission’s Lifeline and Link Up program remains available to low-income consumers regardless of this rule change.<sup>389</sup>

245. In 2010, 1,048 rate-of-return study areas received HCLS support. Using data from the NECA survey filed pursuant to the Protective Order in this proceeding and U.S. Census data from third-party providers, we analyzed monthly local residential rate data for 641 of these study areas and median income data for 618 of those 641 study areas.<sup>390</sup> Based on the 618 study areas for which we have both local rate data and median income data, when we set one variable dependent upon the other (price as a function of income), we do not observe prices correlating at all with median income levels in the given study areas. We observe a wide range of prices — many are higher than expected and just as many are lower than expected. In fact, some areas with extremely low residential rates exhibit higher than average consumer income.

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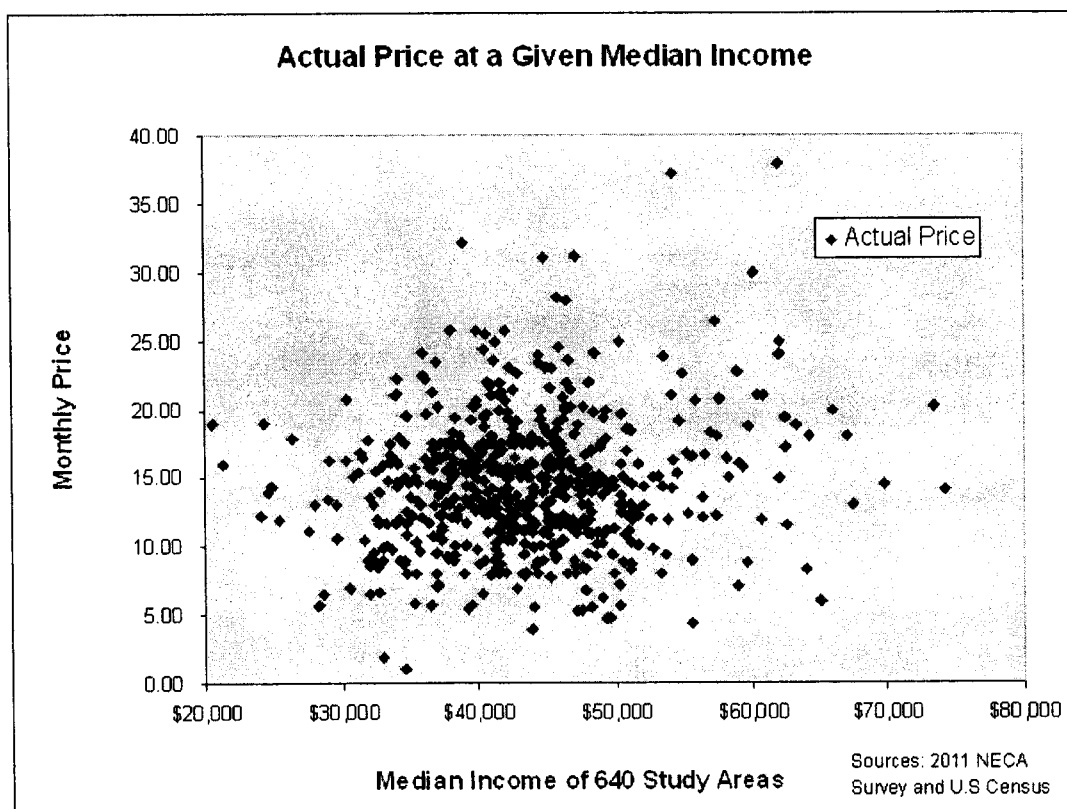
<sup>388</sup> See, e.g., Comments of the Asian American Justice Center at 2 (filed August 24, 2011); see also Comments of the National Association of State Utility Consumer Advocates at 51 (filed April 18, 2011); see generally Reply Comments of the National Association of State Utility Consumer Advocates at 50-51 (filed May 23, 2011).

<sup>389</sup> For more than two decades, the Lifeline and Link Up Program has helped tens of millions of Americans afford basic phone service, providing a “lifeline” for essential daily communications as well as emergencies. See generally *Lifeline and Link Up Reform and Modernization, Federal-State Joint Board on Universal Service, Lifeline and Link Up*, WC Docket No. 11-42, CC Docket No. 96-45, WC Docket No. 03-109, Notice of Proposed Rulemaking, 26 FCC Rcd 2770 (2011).

<sup>390</sup> See NECA Survey. Median income data was based on data from the U.S Census Bureau.



Figure 8



246. To implement these rule changes, we direct that all carriers receiving HCLS must report their basic voice rates and state regulated fees on an annual basis, so that necessary support adjustments can be calculated.<sup>391</sup> In addition, all carriers receiving frozen high-cost support will be required to report their basic voice rates and state regulated fees on an annual basis.<sup>392</sup> Carriers will be required to report their rates to USAC, as set forth more fully below (see Section VIII.A.2, *infra*). As noted above, we have delegated authority to the Wireline Competition Bureau and the Wireless Telecommunications Bureau to take all necessary steps to develop an annual rate survey for voice services.<sup>393</sup> We expect this annual survey to be implemented as part of the annual survey described above in the section discussing public interest obligations for voice telephony. We expect the initial annual rate survey will be completed prior to the implementation of the third step of the transition.<sup>394</sup>

<sup>391</sup> Similarly, companies that receive HCMS will also be required to report their basic voice rates and state-regulated fees, so that USAC can determine any reductions in support that are required.

<sup>392</sup> See *supra* Section VII.C.1.

<sup>393</sup> See *supra* Section VI.A.

<sup>394</sup> See *Modernizing the FCC Form 477 Data Program, Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscriber Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscriber Data, Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering, Review of Wireline Competition Bureau Data Practices*, Notice of Proposed Rulemaking, WC Docket Nos. 11-10, 07-38, 08- (continued...)

247. Finally, we note that the Rural Associations contend that a benchmark approach for voice services fails to address rate comparability for broadband services.<sup>395</sup> Although we address only voice services here, elsewhere in this Order we address reasonable comparability in rates for broadband services.<sup>396</sup> We believe that it is critical to reduce support for voice — the supported service — where rates are artificially low. Doing so will relieve strain on the USF and, thus, greatly assist our efforts in bringing about the overall transformation of the high-cost program into the CAF.<sup>397</sup>

## 6. Safety Net Additive

248. *Background.* In 2001, as part of the Rural Task Force proceeding, the Commission adopted the “safety net additive” with the intent of providing additional support to rural incumbent LECs who make additional significant investments, notwithstanding the cap on high-cost loop support.<sup>398</sup> Once an incumbent LEC qualifies for such support, it receives such support for the qualifying year plus the four subsequent years.<sup>399</sup> Specifically, the safety net additive provides additional loop support if the incumbent LEC realizes growth in year-end telecommunications plant in service (TPIS) (as prescribed in section 32.2001 of the Commission’s rules) on a per-line basis of at least 14 percent more than the study area’s TPIS per-line investment at the end of the prior period.<sup>400</sup>

(Continued from previous page)

90 and 10-132, 26 FCC Rcd 1508 (2011). The Bureau may elect to develop the relevant rate benchmark using data from Form 477 if changes in that collection provide access to relevant pricing information. Even if the Commission does decide to collect pricing information on Form 477, and even if that information will allow the development of a rate benchmark, we recognize that PRA requirements and other timing constraints may limit the availability of such data, particularly in the near future. Therefore, an additional separate survey to implement this rule may be necessary.

<sup>395</sup> Rural Associations *August 3 PN Comments* at 31.

<sup>396</sup> See *supra* Section VI.B.3.

<sup>397</sup> The Rural Associations contend that if the Commission were to adopt the RLEC Plan and also the Ad Hoc Telecommunications Users Committee benchmark approach, it would create the potential for a “double whammy” for rural carriers and their customers; *i.e.*, that there would be two benchmarks — one for USF and one for ICC — with separate and distinct revenue reductions tied to a single rate charged to each customer, dramatically upsetting the careful balance of revenue reductions and support mechanisms. Rural Associations *August 3 PN Comments* at 32. Our benchmark mechanism in the universal service context is a floor for eligibility for support that complements the ICC residential rate ceiling by adding an incentive for local rate rebalancing. If a carrier’s rate is below the benchmark in the USF context, then its payments are reduced by the difference between its rates and the benchmark; *i.e.*, the benchmark rate is imputed to the carrier as the minimum amount a customer is expected to pay and of which USF will not cover. Once a carrier’s rates reach or exceed the benchmark, no reduction would be applied to the high-cost support the carrier would otherwise be eligible for.

<sup>398</sup> 47 C.F.R. § 36.605. The safety net additive was adopted based on the recommendation of the Rural Task Force. See *Rural Task Force Order*, 16 FCC Rcd at 11276-81, paras. 77-90. Specifically, the safety net additive is equal to the amount of capped high-cost loop support in the qualifying year minus the amount of support in the year prior to qualifying for support subtracted from the difference between the uncapped expense adjustment for the study area in the qualifying year minus the uncapped expense adjustment in the year prior to qualifying for support as shown in the by the following equation: Safety net additive support = (Uncapped support in the qualifying year–Uncapped support in the base year)–(Capped support in the qualifying year–Amount of support received in the base year). 47 C.F.R. § 36.605(b).

<sup>399</sup> For the four subsequent years, the safety net additive is the lesser of the sum of capped support and the safety net additive support received in the qualifying year or the rural telephone company’s uncapped support. See 47 C.F.R. § 36.605(c)(3)(ii).

<sup>400</sup> See 47 C.F.R. §§ 36.605(c) and 32.2001.